

BANKING, FINANCE AND CAPITAL MARKETS

IV.

The Bank of Lithuania started receiving
USAID assistance in 1993.

USAID assistance was highly
beneficial in developing practical and
theoretical knowledge of a wide range
of specialties at the Bank. Over the years
of cooperation, USAID advisors helped
the Bank design and implement its
concept of open market
operations, and the principles and
operations of international banking.

This assistance program helped the
Bank of Lithuania to become a
modern Central Bank.



Reinoldijus Šarkinas
Chairman of the Board of
the Bank of Lithuania



Artūras Keleras
President of Central
Securities Depository of
Lithuania

Thanks to USAID assistance, the Central
Securities Depository of Lithuania
acquired know-how and experience
in implementing new financial
instruments (such as, repo), developing
custody functions, drawing up a
Disaster Recovery Plan, as well as
carrying out numerous other projects.

The absence of an adequate legal framework governing loan recovery, foreign branch banking, and depository insurance has constrained the expansion of market-based banking activities during the 1990s. The USAID program of assistance in the banking and finance sector was broadly designed to facilitate the shift from a command to a free-market economy. The 1995-6 banking crisis was a symptom of broader imbalances in the real economy. The causes included inadequate enforcement of bank regulations and poor bank corporate governance. To help remedy these issues, the USAID program focused on developing and strengthening two key elements of market-driven systems - banking and capital markets.

Before 1992, individuals and institutional investors in Lithuania had few alternatives to traditional banks as depositories for accumulated savings. New enterprises or companies requiring capital for expansion were also forced to rely almost entirely on banks, which only provided debt financing. To stimulate the economy through market-based reforms, the Government passed a series of resolutions between 1992 and 1995 to create an institutional framework for a capital market.

USAID maintained its focus on establishing capital markets as a viable alternative to the banking system, with a particular emphasis on strengthening the Lithuanian Securities Commission. Later, it increased its support for additional advisory assistance to capital market development, to introduce a trading system that could cope with growing market activity, to fill gaps in the regulatory environment, and to improve market surveillance and disclosure mechanisms.

Since 1996, USAID has assisted the Bank of Lithuania (BOL) to help accelerate banking sector reforms. These reforms included monetary policy issues, such as forecasting bank reserves and liquidity in the market. In addition, the program provided expert advisors to the Ministry of Finance on corporate governance.

With critical, well-targeted USAID assistance, the Government has made significant progress in creating a well-regulated and relatively efficient capital market. Key working counterparts have been the National Stock Exchange of Lithuania, the Central Securities Depository of Lithuania, the National Association of Finance Brokers, and the Lithuanian Securities Commission. Passage of additional legislation, specifically the Law on Public Trading of Securities, set the stage for building a system of rules, regulations, and procedures to govern the new entities, thus encouraging efficiency in capital market operations.

Discrete USAID assistance activities within the Banking and Finance Sectors include:

- **Monetary Policy:** With the assistance of USAID-financed advisers, the BOL has taken important steps to institutionalize and regularize its role in formulation of monetary policy. These include the establishment of the Committee on Money Market Questions to analyze data and recommend BOL actions, and the initiation of money market liquidity smoothing operations, using repossession agreements and the auction of BOL deposits. The BOL also established a fully collateralized Lombard discount facility. USAID has also worked closely with the BOL Governor on such issues as risks of devaluation, the BOL's relations with state-owned banks, and foreign branch banking. These are issues which the BOL must have the capacity to resolve to function effectively as the nation's Central Bank. As a result of USAID's activities, the BOL is better prepared to correctly time and manage the phase-out of the currency board and litas revision, both of which will facilitate Lithuania's accession into the EU.

- **Credit Institution Supervision:** The BOL has made substantial progress in developing an effective supervisory framework. Manuals outlining uniform inspection procedures for banks and credit unions are now in use, inspectors have been trained in standard bank rating methodologies, and the BOL's newly created Problem Bank Division has developed mechanisms to deal with poorly performing banks. All banks are now required to publish annual audited financial statements, prepared in accordance with International Accounting Standards. A training institute for bankers, the Lithuanian Banking, Insurance and Finance Institute, was set up with USAID support. USAID also played an active role in the passage of a law outlawing money laundering, and in discussions leading to the decision to allow foreign branch banks to operate in Lithuania. With the help of the World Council of Credit Unions (WOCCU), the National Credit Union Association is now in place and the BOL's Bank Supervision Department inspectors have received training specific to credit union operations. With USAID assistance, the Policy Division of BOL's Credit Institutions Supervision Division amended key regulations affecting capital, general reserves, and liquidity, to tighten controls over Russian-related assets and liabilities.

Capital Market Development: In October 1995, USAID, working first through Price Waterhouse and later Pragma, launched a comprehensive program of technical assistance and training to strengthen the four capital market institutions. USAID's involvement in capital market development ensured that reforms were systematic and appropriately timed. The Deposit Insurance Fund is now established. Local professionals were also given a more prominent role in the implementation of the capital markets program through the training of new leadership in the highly technical and complex business of running capital markets. Activity on the stock exchange, a key indicator of successful intervention, has increased significantly since 1995, both in terms of capitalization and turnover.

■ The fifth anniversary of the National
Stock Exchange, September 1998

■ Opening ceremony at the Lithuanian
Banking, Insurance and Finance
Institute, 1997

■ Seminar on Preventing Money
Laundering at the LBIFI, 1996



Working with professional USAID consultants under the Lithuanian Capital Market Development Project, the Exchange improved its level of competence and gained international experience in dealing with both strategic and daily tasks. The most complicated part of the project dealt with the development of a new stock trading system at the Exchange, and implementation of new technologies. Yet it was extremely successful, like all cooperation with USAID.



Rimantas Busila
President of National
Stock Exchange of
Lithuania



Vytas Latinis
WOCCU Project
manager

In partnership with USAID, the World Council of Credit Unions has been assisting credit union development in Lithuania since 1994. Nowadays, credit unions throughout Lithuania provide a wide range of high quality loan and savings products to their members. USAID support enabled WOCCU to develop a network of democratic, sound and safe financial institutions that promote self-help, freedom of choice and serve as a platform for bringing people together.

Based on USAID recommendations, the GOL established a code of ethical conduct for brokerage firms and rules to protect minority shareholders and punish insider trading. In response to a specific request from the Seimas, USAID advisers worked with key counterparts to draft modifications of laws governing companies, securities, and mutual funds, that were generally enacted. The Lithuanian Securities Commission passed a regulation on capital requirements for brokerage firms in November 1997. Then in January 1998, the Commission approved new trading rules for the Exchange. Finally, USAID has helped to prepare new regulations and amendments to existing laws pertaining to both investment companies and brokerage firms.

- **Banking Legislation:** In the fall of 1996, USAID launched an initiative (with the Central and East European Law Initiative) to provide advisers to assist Lithuania's parliament draft new laws on collateral, bankruptcy, competition, and leasing. On the issue of foreign branch banking, USAID worked with the BOL and the Ministry of Finance and successfully encouraged the Government to amend provisions of the commercial bank law which had discouraged the presence of foreign bank branches in Lithuania.

- **Credit Union Development:** The World Council of Credit Unions (WOCCU) project has led to the establishment of a number of financially sound credit unions. USAID provided services and training to support development of credit unions, including: management, membership services, financial monitoring, cash flow management, business planning, reporting, and improving the legislative framework. The legal foundation for the operation of credit unions was established, and by 2000, a total of 33 credit unions were operating. The Bank of Lithuania has drafted a new law that recognized and regulates credit unions, insurance companies and other non-bank institutions.

- **Corporate Governance:** During the banking crisis, USAID financed assistance leading to the privatization of the state-owned banks. Accordingly, USAID assisted the Ministry to focus primarily on privatization of the four state owned banks, establishing a bad loan work out bank (Turto Bankas), and creating an oversight agency for the new Deposit Insurance Fund. USAID also helped the Ministry prepare for country ratings from three international rating agencies, and assisted the Seimas money laundering working group. The Deposit Insurance Agency is performing well, the new country rating has gained Lithuania access to international capital markets, and passage of laws prohibiting money laundering has contributed to enhanced confidence in the banking system.

- **Commercial Bank Training:** USAID, in consultation with the Lithuanian Banking, Insurance & Finance Institute Training Center, organized a training program for Lithuanian commercial bankers. This included a 'training of trainers' course held in the U.S. as well as specialized courses offered in Lithuania in such areas as credit analysis and asset and liability management. During 1995-1998, the Training Center has provided educational services for approximately 400 people, including bankers, financial specialists of credit union representatives, and decision-makers from Government authorities.

- **Commercial Bank Assistance:** A commercial bank assistance program was specifically geared to increasing the eligibility of banks to receive credit from the World Bank under its Enterprise and Financial Sector Assistance Project. The program was complementary to an on-going USAID effort to improve bank operations through assistance to the BOL's Bank Supervision Division. USAID tapped into an existing relationship with the International Executive Service Corps to help resolve the banking crisis by providing short-term advisers to Litimpeks Bank in credit management, auditing, and strategic planning/training and to Siauliai Bank in marketing, strategic planning, and auditing. The goals, which have been essentially achieved, have been to support the development of a safe and sound banking system that operates according to market principles, to develop a more stable financial environment, and to increase public confidence in the banking system.

Kazimieras Ramonas
Director of the Credit
Institutions Supervision
Department of the Bank of Lithuania



The consultations provided by USAID advisors have significantly contributed to the quality of supervisory practices and procedures at the Credit Institutions Supervision Department of the Bank of Lithuania. Constructive cooperation with resident advisors gave positive results in developing a sound supervisory system, and strengthened such areas as on-site bank inspections, off-site monitoring, dealing with problematic credit institutions, etc.